

**DEPARTMENT OF STATE REVENUE
SUPPLEMENTAL LETTER OF FINDINGS: 05-0462
Corporate Income Tax
Tax Period 2000-2002**

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ISSUES

I. Corporate Income Tax—Adjusted Gross Income Tax Adjustments

Authority: IC § 6-3-2-2; IC § 6-8.1-5-1; P.L. 86-272 (15 U.S.C. §§ 381-385)

Taxpayer protests adjustments made to its payroll factor and sales factor for adjusted gross income tax purposes.

II. Tax Administration—Penalties

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the assessment of penalties.

STATEMENT OF FACTS

Taxpayer, an Indiana based company, sells parts to automobile manufacturers. Prior to 2001, Taxpayer manufactured a majority of its parts. After 2001, Taxpayer purchased its parts from its wholly-owned subsidiary (hereinafter referred to as "Company A"). In addition to Company A, Taxpayer owned eighty percent of a company (hereinafter referred to as "Company B") and one-hundred percent of another company (hereinafter referred to as "Company C"). Both Company A and Company B are located in Indiana. Company C is located outside of Indiana. All of the companies are involved in the production or sale of automobile component parts.

The Indiana Department of Revenue ("Department") adjusted Taxpayer's payroll factor and sales factor for apportionment purposes for the tax period 2000 through 2002. Taxpayer's ensuing protest proved unsuccessful. Taxpayer requested and the Department granted a rehearing and this supplemental letter of findings results. Any issues not specifically addressed in the discussion below are determined in a manner consistent with the Department's assessment and the previous letter of findings.

I. Corporate Income Tax—Adjusted Gross Income Tax Adjustments

DISCUSSION

Indiana Department of Revenue assessments are prima facie evidence the department's claim for unpaid taxes is valid. IC § 6-8.1-5-1(b). The taxpayer has the burden of proving whether the department incorrectly imposed the assessment. *Id.* Taxpayer separately addressed these adjustments in its rehearing request.

A. Payroll Factor—Ohio

Taxpayer argues that the payroll numerator used by the Department erroneously included employees that worked in Ohio. The Department based its original determination of Taxpayer's Indiana payroll on information that Taxpayer submitted for state unemployment taxes. Taxpayer included the employees as Indiana payroll for unemployment tax purposes. Taxpayer did not pay unemployment taxes to Ohio; however, Taxpayer acknowledges that it should have paid Ohio unemployment taxes with respect to the employees.

Under IC § 6-3-2-2(d):

The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the taxable year by the taxpayer for compensation, and the denominator of which is the total compensation paid everywhere during the taxable year. However, with respect to a foreign corporation, the denominator does not include compensation paid in a place that is outside the United States. Compensation is paid in this state if:

- (1) the individual's service is performed entirely within the state;
- (2) the individual's service is performed both within and without this state, but the service performed without this state is incidental to the individual's service within this state; or
- (3) some of the service is performed in this state and:
 - (A) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in this state; or
 - (B) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual is a resident of this state.

With respect to this issue, Taxpayer has provided sufficient documentation to conclude that the employees conducted their services in Ohio. Therefore, the employees should have been treated as Ohio employees for apportionment purposes and Taxpayer is sustained with respect to this subissue.

B. Payroll Factor—Denominator

Taxpayer further argues that the denominator of the payroll factor should have included an employee who worked in Canada. IC § 6-3-2-2(d) states in relevant part (emphasis added):

The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the taxable year by the taxpayer for compensation, and the denominator of which is the total compensation paid *everywhere* during the taxable year. *However, with respect to a foreign corporation, the denominator does not include compensation paid in a place that is outside the United States.*

Company B—the company for whom the employee worked—is not a foreign corporation. Thus, the denominator includes compensation of all employees, not merely those in the United States. Further, the unemployment tax records of Taxpayer would not reflect the employee because the employee was not employed in Indiana or any other state in the United States. Taxpayer also has provided sufficient documentation to conclude that the employee was an actual employee of Taxpayer, and therefore is sustained with respect to this subissue.

C. Sales Factor

Taxpayer also protests the Department's determination that certain sales should be included in Taxpayer's Indiana sales numerator. In particular, Taxpayer argues that it had sufficient activities to be subject to adjusted gross income tax in several jurisdictions. Thus, Taxpayer argues that its sales to locations in those jurisdictions should be attributed to those jurisdictions rather than to Indiana.

The section for determining whether a sale is attributable to Indiana or another jurisdiction, IC § 6-3-2-2(e), states in relevant part:

The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year. Sales include receipts from intangible property and receipts from the sale or exchange of intangible property. However, with respect to a foreign corporation, the denominator does not include sales made in a place that is outside the United States. Receipts from intangible personal property are derived from sources within Indiana if the receipts from the intangible personal property are attributable to Indiana under section 2.2 of this chapter. Sales of tangible personal property are in this state if:

- (1) the property is delivered or shipped to a purchaser, other than the United States government, within this state, regardless of the f.o.b. point or other conditions of the sale; or
- (2) the property is shipped from an office, a store, a warehouse, a factory, or other place of storage in this state and:
 - (A) the purchaser is the United States government; or
 - (B) the taxpayer is not taxable in the state of the purchaser.

Under the above-cited section, the jurisdiction to which property is shipped or delivered is generally the state to which a corporation attributes the sale.

However, if the corporation is not subject to a net income tax in the jurisdiction to which property is shipped or delivered because of constitutional or statutory constraints such as P.L. 86-272 (15 U.S.C. §§ 381-385), the corporation attributes the sale to the jurisdiction *from* which the property is shipped or delivered. The corporation is also treated as not being subject to a net income tax in foreign countries if the corporation would not be subject to tax if P.L. 86-272 was applied to the foreign countries in the same manner as it applies to states.

Taxpayer has provided sufficient information to conclude that sales made to Canada, North Carolina, and Ohio destinations were subject to net income taxes in those jurisdictions within the meaning of P.L. 86-272, and is therefore sustained with respect to the attribution of sales made to locations in those jurisdictions. Taxpayer otherwise is denied with respect to sales made to other jurisdictions.

Taxpayer also raised an issue with respect to certain sales initially reported by Taxpayer as being made to Michigan customers. Taxpayer has provided information that indicated that Taxpayer made only \$8,750 of sales to Michigan customers, with the balance going to customers in other jurisdictions. These sales have been broken out by the other jurisdictions, and the attribution of these sales is determined by the previous paragraph.

FINDING

Taxpayer's protest is sustained in part and denied in part as provided above.

II. Tax Administration- Penalties

Taxpayer protests the imposition of the ten percent negligence penalty for the taxes that the Department has imposed.

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC § 6-8.1-10-2.1. The Indiana Administrative Code, 45 IAC 15-11-2, further provides:

(b) "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

(c) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary

business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer has provided sufficient information to conclude that the positions taken with respect to its tax returns and computations were reasonable, even though the Department respectfully disagreed with some of its contentions. Accordingly, Taxpayer has demonstrated that it acted with ordinary business care with respect to its responsibilities under Indiana law.

FINDING

Taxpayer's protest is sustained.